The economic crisis in Greece

Reading project

Group 8

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Introduction

The greek debt crisis is an ongoing economical crisis in Greece which officially started as a consequence of the global financial crisis in 2008. A lack of control, both within the country but also from the EU on Greece has led to several fatal consequences. The country was on the edge to default but was aided by loans from the EU in order to survive. The greek crisis is a part of the debt crisis that troubled many countries in southern europe which for example includes Italy. How could this happen and what was done to handle it? We will try to answer these questions along with what could have been done differently in this report.

How did the crisis start?

It all started when Greece joined the EMU in 2001 without living up to the criterias about inflation rate, budget surpluses, and the criterias for financial stability. EMU stands for "Economic and monetary union" and is a cooperation between countries in the EU to integrate with each other regarding currency, monetary policies and such.

Since Greece joined EMU after all, the country experienced some positive effects from it. For example they now got loans for a much lower interest rate and therefore they could increase their loans. Also the inflation decreased and the budget stabilized, at least on paper.
These benefits led to an economic growth during the early 2000. In average the country's GDP increased with 4.2 per cent per year between 2000 and 2007. This impressive growth led to a large inflow of foreign capital to the country and the growth in combination with low interest rates on the public debt made it possible for the greek government to allow a large budget deficit. This was partly because the labor costs increased when Greece started implementing the euro money system without increasing productivity meaning they were left with just higher costs. This resulted in a higher trade deficit which means that Greece's spending was a lot bigger than it's incomes. By the financial crisis around 2008 both the budget deficit and the trade deficit had gone from under 5 % of GDP to almost 15 per cent of GDP (Scocco, 2015).

Because of the global financial crisis in 2008 this growth soon became a decrease in the economy. As the financial crisis reached Greece, the whole growth situation quickly changed into a depression. When this happened, the core countries in the EU such as Germany and France couldn't keep lending funds to Greece anymore since they needed to take care of their own economy. This meant that Greece could no longer get the money they needed which led to a much higher debt and a stop of money inflow to the country. Usually when a country is put in a situation like this with a really high debt and no money, the currency depreciates, investment increases and the country can pay its debt in a devalued currency (White 2010). Since Greece used the Euro system, this wasn't possible and the crisis instead became worse. As if this wasn't enough, during 2010 it also turned out that earlier greek governments had reported false economic statistics just so the country would stay within the monetary guidelines of the european monetary union (EMU). It also turned out that Greece had paid millions of dollars to large corporate banks to arrange transactions to hide Greece´s actual public debt (Blodget, 2010).

The false reporting were margianall and what had a larger impact on the upcoming crisis were the EMU:s adjusted guidelines with less requirements regarding public debt.
Earlier the requirements were a public debt for at most 60 % of a country's GDP, but to include for example Italy and Greece in the monetary union, this requirement was changed to 100% of the GDP. Because of all this, even though the global financial crisis hit the whole world very hard, it affected Greece even harder.

Austerities

Since 2010 the greek government have voted through five austerities. The reforms included in these austerities has for example been decreased bonuses and a decreased amount of public employees. Also the VAT has been increased as well as taxes on alcohol, tobacco and fuel. The retirement age was increased from 61 years to 65 years. Also the minimum wage was lowered and the pensions was decreased within a total of 300 million euro during 2012. The mentioned reforms are just examples and a lot more was implemented (BBC, 2011).

These austerities met discontentment among the greek people, and was followed by walkouts and demonstrations which led to three deaths, dessins of people hurt and 107 people arrested in 2010(news.com.au 2015). Even though the reforms was not appreciated by the people of Greece, they were a requirement from the other countries in the EMU and from the IMF in order to provide Greece with an emergency loan. In total, Greece has received approximately 240 billion euros in loans from the IMF and the EMU. This is the largest loan package in the history. Since greece will have a hard time paying back the loans, the lenders have accepted a depreciation.

How has it affected Greece?

Greek GDP has fallen from approximately 355 billion USD to 193 billion USD between late 2009 and 2016 which means that the average fall was 6.5 per cent per year for seven years during the crisis. The rate of unemployment rose from 10 to 25 per cent between 2009 and 2015. (The World Bank, n.d)

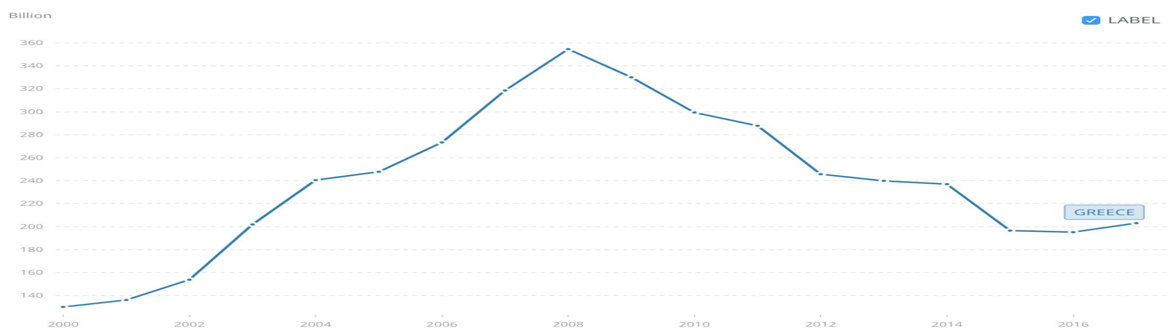

Figure 1: GDP evolution of Greece from 2000 - 2018 (The World Bank, n.d)

One of the responses from the Greek government was to increase tax rates. The rates was almost doubled from the beginning of the crisis until 2017 which has led to a lot of people avoiding paying taxes and trying to find ways to escape paying their taxes. The tax evasion losses from collections for the greek government in 2010 was approximately 20 billion USD and was even higher during the following years. (PwC, 2018)

The social effects of the crisis are and have been many. In 2012 it was reported that 20 thousand people had become homeless during 2011 and also that 20 per cent of the stores in Athens in the historic city centre were empty. The Greek population suffered from a major financial shock and in 2015 the organisation for economic co-operation and development (OECD) gave reports that almost 20 per cent of the population had problems to afford the daily food needs. Eurostat gave out a study that showed that about 30 per cent of the inhabitants in Greece lived below the poverty conditions in 2016. (Karnitschnig & Stamouli, 2015)

What was done to avoid tax evasion?

The government saw a very serious issue in the tax evasion and decided to push the companies towards cash-free payments. This would mean that people had to pay with a credit card and that all payments left a trail which could be tracked. Therefore, people and companies wouldn't be able to avoid the VAT by paying cash. The Greece government decided that many companies, by law, had to install saledevices in their stores so that the customers would at least have the opportunity to pay by card. For those who failed to fulfill this requirement, there was a 1500 euro fine that had to be paid. This law and decision was one of the things that helped Greece return to a higher level of tax collection again. (Malkoutzis, 2017)

Other possible solutions

Some people suggested that Greece should leave the European Union (EU) which was called "Grexit". Those in favor of this implied that this would allow the country to return to their own national currency which would give the government control over the internal monetary policy. Furthermore, it would let Greece steer over growth and inflation and make the necessary trade-offs inside the country instead of being forced to take the whole European Union's consequences in consideration (Krugman, 2015).

The majority of people still preferred staying in the EU because of several reasons. One of them being that the decision would be seen as irrevocable and that it would lead the financial markets to think that there was a bigger risk for other nations to leave as well. If this would have been the outcome, then the interest rates of the bonds and such in those countries might have risen and this would have made the debt service situation complicated. (Krugman, 2015)

Another reason was that the other EU countries along with the International Monetary Fund (IMF) would have lost a lot of money since the IMF has loaned Greece more than 200 billion euro. Furthermore the banking system in Greece are relying on a lot of other countries in the EU since that’s where they get a lot of their capital from which means that it might have collapsed if Grexit would have happened. (Krugman, 2015)

As mentioned earlier Greece accepted and received several bailout packages from EMU and the IMF to help stabilize the situation and prevent bankruptcy in the country. More packages could have been accepted if the country could accomplish a greater austerity. However, this is a very difficult question since austerity is a big cause for a lot of damages as well as positive outcomes. Many people have been fired, wages have deflated and tax receipts has been reduced leading to the country having it even harder to pay its’ debts. But if the country could have managed to pay off enough debts in exchange for the austerity increase, then this process might have been justifiable. (Harrison & Liakos, 2015)

How has it affected the rest of the world?

Since the crisis in Greece started as a consequence of the global financial crisis it is hard to say whether the consequences came from one or the other. But since the outbreak of both crisis, the unemployment rate grew from 6.8 per cent in 2008 to 11 percent in 2013 for the countries within the european union. Also from 2008 the combined GDP of the european union has decreased from 19.137 in 2008 to 17.339 trillion USD in 2017 while America's GDP has grown from 14.719 to 19.485 trillion USD during the same time interval. The difference in GDP development between the two economic zones could be a result of the debt crisis in europe.

The debt crisis has made a large structural problem visible within the eurozone. For example the irregular growth in GDP across the zone and the lack of an effective mechanism for controlling the finances and the monetary policies within the zone. This has made investors more critical to the euro project and will therefore be more critical to the bonds issued within the eurozone which may lead to a decrease in production growth within the EMU.

The debt crisis also affected many of the worlds emerging countries. For example India, that exports a lot to europe, was affected negatively by the situation. India's export decreased, which led to decrease in the countries industrial growth. As the decrease in export led to an increase in india's current account deficit which led to depreciation of the indian currency. (economics discussion, 2011)

It is not only the emerging countries that has suffered from the european debt crisis. Since Europe is the second largest economy in the world, after USA, of course a decrease in demand here will be a problem for countries exporting to europe. This was not only shown in the american current account deficit but also the crisis affected the stock market in America. As much as 25 per cent of all the earnings from the S&P 500 index companies comes from

Europe so of course a decrease in demand in Europe will also affect the american companies (Steiner, 2012).

Conclusions and own thoughts

In our opinion the European Union has been to easy on Greece, mainly in the beginning. Before Greece entered the EU, one of the main demands to enter was that your debt-to-GDP ratio was 60 % but since the EU saw short term benefits from adding more countries into the EU, they raised the limit to a 100 % in order to allow more countries to enter. The EU also let countries like Greece enter without living up to other terms that they have for the same reasons.

Figure 2: Grecce’s debt to GDP ratio (Tradingeconomics, n.d.)

Another thing that was made sloppy was the follow-up of the greek bookkeeping. Since Greece reported false numbers in their bookkeeping and it was overlooked, they were allowed to keep spending carelessly without anyone stopping them. The false reports has been going on for many years before the crisis and Greece have been spending and building for more than they collect which has gotten them out of balance. This should be much more strict and controlled so it doesn’t happen, especially when countries enter the EU because then it concerns the other members even more.

Reading tips:
http://web.b.ebscohost.com/ehost/pdfviewer/pdfviewer?vid=0&sid=7ebc0959-1f9b-4715-a592-296a73342614%40sessionmgr104
“Macroeconomic and credit forecasts during the Greek crisis using Bayesian VARs”
Level: High
If someone is up for a higher level of match and statistics with very interesting and relatable reading one should read this. An article that brings up Bayesian vector autoregressions as a tool for credit forecasts in the Greek crisis. A vector autoregression is a stochastic process which is used to find linear interdependencies in more than one time series.

https://journals.sagepub.com/doi/pdf/10.1177/0486613417730363
“Political Economy of the Greek Crisis”
Level: Intermediate
A good and comprehensible article that covers a lot of relevant political and economical parts during the crisis and its effects. One of the main subjects is how and why the Eurozone's actions affected Greece.

https://thewire.in/economy/thomas-piketty-germany-has-never-repaid-its-debts-it-has-no-right-to-lecture-greece
“Germany has never repaid its debts. It has no right to lecture Greece.”
Level: Beginner/intermediate
In 2015 Thomas Piketty, who is a star economist, said that a conference between the countries in the EU was needed to overhaul all of the European debts which he made a similarity to the second world war. The conference’s intentions was to restructure all the loans to create a sustainable situation. This is an example that shows how bad it was during this time and Piketty was one of those who was strongly against Grexit. He also mentioned that if EU started forcing countries out, then the financial markets would quickly start turning on new countries and this would create a massive evil spiral. A very interesting reading tip if you want to read about it from a different perspective.

Video tips:
https://www.youtube.com/watch?v=52_wAgLurH4
“Greek debt crisis explained 2017”
Level: Beginner
This video is a relatively recent video explaining the greek debt crisis in a very easy way and including a large width of time and information. It explains the background of the Euro-zone and the reasons behind it along with how it came to bring a lot of problems for Greece. But be aware that this is not a scientific report and the videos purpose is just to give an overview of the essential information about the crisis.

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